STATEMENT OF COMMISSIONER JOHN C. WEICHER

ASSISTANT SECRETARY, OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE

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SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

COMMITTEE ON FINANCIAL SERVICES

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Chairman Ney, Ranking Member Waters, distinguished members of the Subcommittee on Housing and Community Opportunity, on behalf of Secretary Martinez, thank you for inviting the Department to testify on the subject of H.R. 1985, the FHA Multifamily Loan Limit Adjustment Act of 2003. We appreciate this opportunity to provide the Committee with the Department's comments on this proposed legislation.

The Administration and the Department are firmly committed to having FHA participate as a strong and effective player in the financing of rental housing nationwide. We have taken several major actions in that effort. First, we have put the multifamily insurance programs on a sound actuarial basis, enabling most of them to operate without the need for appropriated credit subsidy. Second, we have instituted an annual process of updating the mortgage insurance premiums, so that they continue to operate on a breakeven basis. Third, we have established a much faster underwriting process, saving the industry time and money. Fourth, we asked Congress for a 25 percent increase in the multifamily mortgage limits – the first increase in 10 years. Secretary Martinez called for this increase shortly after taking office.

This Administration inherited serious problems in FHA's basic multifamily housing insurance program-the Section 221(d)(4) program. This program previously required a credit subsidy allocation pursuant to the Federal Credit Reform Act enacted in 1990. Three times in eight years, the program was closed down because the available credit subsidy allocation was exhausted. The last time was in May 2001, when the Department was forced to suspend multifamily insurance processing. To prevent further such closures, the Department determined to place the program on a break-even basis. This necessitated raising the premium from 50 basis points to 80 basis points for FY 2002. Many in the industry were very concerned by this necessary increase. They worried that it would weaken the viability of the program and its ability to serve moderate-income families. That did not happen. In FY 2002, FHA insured 2.8 billion worth of Section 221(d)(4) projects, nearly double the FY2001 total, and the largest volume in twenty years.

At the same time that the premium was raised, the Department made a commitment to conduct a systematic analysis of the process used to determine the break-even premium and the credit subsidy rate. This was the first such re-analysis since Credit Reform was enacted in 1990. We found that the Section 221(d)(4) program could be operated on a break-even basis at a much lower premium - 57 basis points. This premium went into effect at the beginning of FY 2003. In addition, we instituted a process of annual re-analyses, to determine what the appropriate premium should be. As a result, the premium will be cut to 50 basis points in October, the start of FY 2004.

We also conducted this analysis for each of our other multifamily programs, and have been able to reduce either the premium or the credit subsidy for nearly every other multifamily program. All but four of our programs are now self-supporting, and do not require credit subsidy.

These efforts by this Administration have ensured that the 221(d)(4) program will not repeat the experience of past shutdowns. Mortgage bankers and developers are assured that they can continue to bring loans to the Department.

Moreover, once applications come to the Department, we now process them faster. All loan applications are now processed under the Department's Multifamily Accelerated Processing, or MAP, initiative. MAP was instituted on a national basis in FY2001. MAP provides guaranteed processing time frames, and it has resulted in a significant increase in mortgage applications and endorsements.

Our other major initiative has been to increase the mortgage limits. As I mentioned, shortly after assuming office Secretary Martinez called for a 25 percent increase in the statutory loan limits - the first such increase in a decade. Congress enacted that request in 2002.

Also in 2002, Congress approved indexing the FHA mortgage limits in Section 5 of the FHA Downpayment Simplification Act of 2002, commencing in January 2004. This indexing will further increase the loan limits, year by year. It will enable FHA to keep pace with inflation and changing economic conditions, and to meet the needs of families seeking moderately priced rental housing. Clearly, annual adjustments provide a better way to compensate for increased costs than by providing periodic dollar increases. The 2002 increase represented a catch-up for the inflation that occurred during the preceding decade. As indexing will not take effect until 2004, the Department cannot at this time determine to what extent it will increase FHA mortgage activities.

Thanks to all of these changes, in FY 2002 FHA insured over $7 billion worth of projects for all multifamily insured housing programs combined. This is our highest overall production level since the inception of the mortgage insurance programs. The projections for FY 2003 indicate that we will be exceeding the FY 2002 numbers. Through the first three quarters of FY 2003, 913 loan commitments for a total of $5.3 billion have been issued, a nine percent increase in mortgage activity compared to last year at this time, with one quarter remaining in the fiscal year. Having set a record last year, we appear to be on course to break it this year. Based on the increasing number of loan commitments over the last two years, the Department believes that the FHA multifamily mortgage insurance products, under current limits, meet the market needs in the great majority of this country.

Moreover, we are seeing applications from high-cost metropolitan areas that have not participated in the program in years - Philadelphia, Baltimore, here in Washington DC, and Seattle.

At the same time, I am pleased to report that the Department continues working vigorously to assist sponsors to close Section 202 Capital Advance projects to ensure that this needed affordable housing is built for low-income, elderly persons. We inherited a long pipeline of projects that had been approved years before, and we cleaned out that pipeline. In 2001, there were 48 projects that had been in the pipeline for at least four years - double the processing schedule established by the Department. Today, there are only 6 projects remaining. Although it is not the topic of this hearing, Mr. Chairman, I want to bring this to your attention as further evidence of the Department's commitment to provide affordable housing for people who need it.

However, there are areas where FHA insurance products are underutilized, such as San Francisco, Los Angeles, Boston, and New York. Based on discussions with our Field Office personnel and industry groups, there appears to be a variety of reasons for the lack of multifamily production in these areas. These reasons include: 1) suitable sites are not readily available; 2) available sites often have substantial environmental issues that render them cost prohibitive; 3) available sites are located in areas that are not marketable (i.e. no public transportation) and 4) regulatory barriers which add years to processing times. These local market issues will remain regardless of the proposed legislation.

Traditionally, FHA mortgage insurance has served an important public purpose by insuring projects that are affordable to low-to-moderate income families. It's important to make sure that FHA continues to serve that purpose -- that increases in the mortgage limits do not put FHA into higher-income housing, at the expense of moderately priced rental properties. That could be the case if the regulatory, environmental, and other problems mentioned above are the main reasons why multifamily housing is not being built in some areas. Increases in FHA loan~~s~~ limits must be carefully scrutinized for their net impact on affordable housing and these benefits must be weighed against any increased risk that the FHA Fund would face. It is worth noting that the national rental vacancy rate is 9.4 percent, the highest level in forty years. Given this, it is important that FHA exercise prudent underwriting and control of credit risk in an environment where there is a risk of over-supply of housing. At the same time, we certainly recognize that rental housing is more expensive in some markets than in others.

When we raised the mortgage limits, The Department made a commitment to study the impact of the increase, with particular reference to high-cost areas. We are now conducting that study, looking at 18 months' experience with the new limit. This study will be completed this fall and will provide the data to determine if further increases to the mortgage limitations are warranted to serve high-cost markets. Until then, the Department is not in a position to support this proposed legislation at this time.